FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Bank of Ireland Group plc at 'BBB'; Outlook Stable

Fri 16 Sep, 2022 - 11:59 AM ET

Fitch Ratings - Milan - 16 Sep 2022: Fitch Ratings has affirmed Bank of Ireland Group plc's (BOIG) Long-Term Issuer Default Ratings (IDRs) at 'BBB' and its main operating subsidiary, Bank of Ireland's (BOI) Long-Term IDRs at 'BBB+'. The Outlooks are Stable. Their Viability Ratings (VRs) have been affirmed at 'bbb'.

Fitch has withdrawn BOIG's and BOI's Support Ratings (SR) of '5' and Support Rating Floors (SRF) of 'No Floor' as they are no longer relevant to the agency's coverage following the publication of its updated Bank Rating Criteria on 12 November 2021. In line with the updated criteria, we have assigned BOIG and BOI Government Support Ratings (GSR) of 'no support (ns)'.

KEY RATING DRIVERS

Leading Domestic Bank; Diversified Business: BOIG's ratings are driven by the group's reasonably diversified business model; a leading retail and corporate-banking franchise primarily focused on the small and concentrated Irish market; sound regulatory capitalisation; and a stable funding and liquidity profile. The ratings also consider the group's asset quality, which is weaker than that of international peers, still influenced to some extent by impaired loans underwritten before the global financial crisis.

Above-Average, but Stable, Impaired Loans: BOIG has been reducing its stock of impaired loans (Stage 3) in recent years through workouts and portfolio sales. Its impaired loans ratio stayed flat at 5.3% at end-1H22 from end-2021, while the Stage 2 loans ratio decreased to 13.4% from 15.8%, mainly due to declines in pandemic-driven management adjustments. We expect the impaired loans ratio to decline in 2022 from impaired loans disposals and then remain stable from new inflows, despite planned impaired loan disposals and loan acquisitions.

Prospects of Increasing Earnings Diversification: BOIG's profitability is supported by its reasonably diversified business model and a leading market position in Ireland, which will benefit from the acquisitions of Davy's stockbrokers and KBC Ireland's performing loans and deposits. The acquisition of Davy's stockbrokers will support diversification towards non-interest revenue, which is already a strength relative to domestic peers, due to BOIG's larger wealth management and insurance activities.

Adequate Capitalisation: The group's regulatory capital and leverage ratios are sound. Its transitional common equity Tier 1 (CET1) ratio of 16.0% at end-1H22 (15.5% fully-loaded) was well above the 2022 minimum regulatory requirements of 10.07% (excluding Pillar 2 Guidance). BOIG's end-2021 leverage ratio of 6.6% was comfortable. Capital encumbrance by unreserved impaired loans, at 28% of CET1 capital at end-2021, remains fairly high compared with peers.

Stable Funding, Rating Strength: The group benefits from a strong retail-banking franchise and access to a stable and granular deposit base, particularly in its home market. Non-interest-bearing current account balances make up a large proportion of total customer deposits. In addition, the group has proven and diversified access to the wholesale markets, which it regularly taps principally for minimum requirement for own funds and eligible liabilities (MREL) purposes, given abundant customer deposits. Liquidity is sound and largely in the form of cash and cash equivalents and high-quality liquid assets, supported by contingent access to liquidity through various central bank facilities.

Holdco VR Equalised with Opco: Fitch assesses BOIG (the group's holding company) on a consolidated basis. Its VR is aligned with that of its main operating subsidiary, BOI, which is also based in Ireland, to reflect the absence of material double leverage at the holding company, prudent liquidity management with contingency plans in place, and the fungibility of capital and liquidity across the group, subject to its operating companies fulfilling their regulatory requirements.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Deteriorating Operating Environment, Asset Quality: The ratings would likely be downgraded if a deterioration of economic performance and the operating environment for banks in Ireland and the UK increases the group's impaired loans ratio towards 10%, and BOIG is unable to reduce its stock of impaired loans fairly quickly, or if capital encumbrance by impaired loans increases significantly without prospects of recovering within a reasonable timeframe. This is not our baseline scenario.

The ratings would also be downgraded if the group's fully loaded CET1 ratio fell below 13%, following losses or risk-weighted assets (RWA) increased without prospects of sufficient internal capital generation.

BOIG's VR would also be downgraded if the holding company's double leverage durably increases to above 120%, which we do not expect.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Improved Asset Quality and Profitability: An upgrade would require the group to generate operating profit/RWAs sustainably above 2%, reduce impaired loans to about 3% of gross loans, and significantly reduce capital encumbrance.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

BOIG's Long-Term IDR and long-term senior debt rating are in line with the group's VR.

BOI's Long-Term IDR, DCR and long-term senior debt rating are one notch above the bank's VR to reflect the protection of BOI's senior third-party creditors by resolution funds ultimately raised by BOIG, down-streamed to BOI and designed to protect the operating company's external senior creditors in a group failure. The buffers of junior and down-streamed holding-company senior debt are built to comply with MREL.

BOIG's Short-Term IDR and short-term senior debt ratings are the higher of two options corresponding to the group's 'BBB' Long-Term IDR and long-term senior debt ratings. BOI's Short-Term IDR and short-term senior debt ratings are the lower of two options corresponding to the bank's Long-Term IDR and long-term senior debt ratings of 'BBB+'. This is based on our assessment of the group's funding and liquidity, which at 'bbb+' warrants 'F2' short-term ratings.

BOI's DCR is aligned with the bank's Long-Term IDR because under Irish legislation, derivative counterparties have no preferential status over other senior obligations in a resolution.

Subordinated Debt: The rating of BOIG's and BOI's subordinated Tier 2 debt is notched down twice from the respective VRs. This reflects the notes' poor recovery prospects arising from their subordinated status in a resolution. We do not notch for non-performance risk because the terms of the notes do not provide for loss absorption on a going-concern basis.

Additional Tier 1 Instruments: BOIG's additional Tier 1 notes are rated four notches below the group's VR. This reflects poor recovery prospects arising from their subordinated status (two notches) as well as incremental non-performance risk relative to the VR (two notches), given fully discretionary coupon payments and mandatory coupon restriction features.

No Government Support Expected: BOIG's and BOI's GSRs of 'ns' reflect Fitch's view that senior creditors cannot rely on extraordinary support from the Irish authorities in the event that the bank becomes non-viable. In our opinion, the EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism provide a framework that is likely to require senior creditors to participate in losses for resolving the bank.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

The IDRs, senior debt ratings and DCR of BOI and BOIG would be upgraded if their respective VRs were upgraded and if the resolution buffer continues to provide BOI's senior creditors and derivative counterparties with additional protection.

BOI's and BOIG's IDRs, senior debt ratings and DCR could be downgraded if the VRs were downgraded, or if we no longer estimate that the resolution debt buffer provides BOI's senior creditors and derivative counterparties with additional protection.

BOIG's Short-Term IDR and short-term senior debt rating are also sensitive to a negative reassessment of the group's funding and liquidity.

The ratings of all subordinated instruments are primarily sensitive to a change in the VRs, or to changes in their notching should Fitch change its assessment of loss severity or relative non-performance risk.

Changes in Ability or Propensity to Support: An upgrade of the GSR would be contingent on a positive change in the Irish authorities' propensity to support its banks. While not impossible, this is highly unlikely, in Fitch's view.

VR ADJUSTMENTS

The 'a-' operating environment score has been assigned below the 'aa' implied score due to the following adjustment reasons: Size and Structure of Economy (negative) and Level and Growth of Credit (negative), Reported and Future Metrics (negative). The operating environment score is one notch higher than that applied to overwhelmingly domestic banks to reflect BOIG's international diversification in the UK.

The 'bbb' capitalisation & Leverage score has been assigned below the 'a' implied score due to the following adjustment reason: Reserve Coverage and Asset Valuation (negative).

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Bank of Ireland Group plc	LT IDR	BBB Rating Outlook Stable	Affirmed	BBB Rating Outlook Stable
	ST IDR	F2	Affirmed	F2

	Viability bbb Affirmed		bbb
	Support WD Withdrawn		5
	Support Floor WD Withdrawn		NF
	Government Support ns New Rating		
subordinated	LT BB+ Affirmed		BB+
senior unsecured	LT BBB Affirmed		BBB
subordinated	LT BB- Affirmed		BB-
Bank of Ireland	LT IDR BBB+ Rating Outlook Stable Affirmed		BBB+ Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 07 Sep 2022) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Bank of Ireland	EU Issued, UK Endorsed
Bank of Ireland Group plc	EU Issued, UK Endorsed

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Banks Europe Ireland